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RUEHBJ/AMEMBASSY BEIJING 3779
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SIPDIS

SIPDIS

DEPT FOR EAP/MTS AND EB/IFD/OMA
TREASURY FOR IA-SETH SEARLS
COMMERCE FOR 4430/GOLIKE
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR FINEMAN
DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [PGOV](#) [ID](#)

SUBJECT: INDONESIA - ECONOMIC AND FINANCIAL HIGHLIGHTS DECEMBER
2006

11. Summary. The Central Bureau of Statistics (BPS) announced on January 2, 2007 that December inflation rose to 1.21% month-on-month (MoM), mainly due to higher rice prices. On January 4, Bank Indonesia (BI) cut its benchmark interest rate by 25 basis points (bps) to 9.5%, a signal that the bank is likely reducing the rate of monetary policy loosening after five consecutive months of 50-bps cuts. On December 5 the Ministry of Finance (MOF) swapped \$687 million worth of bonds maturing in 2007 - 2011 for bonds maturing in 2025 at an 11% yield. A December 14 MOF budget realization report showed actual Government of Indonesia (GOI) spending was only 75% of budgeted expenditure as of late November 2006, but spending rose to 96% of targeted levels by the end of December. The MOF also announced that unlike in 2005, it would not simply carry over unspent funds into the same spending categories in the next fiscal year. On December 14, 2006 Parliament approved salary increases of 3-10% for BI employees. Indonesia's Financial Intelligence Unit, the Pusat Pelaporan dan Analisa Transaksi Keuangan (PPATK), signed memoranda of understanding (MOU) on December 5 with South Africa and the Cayman Islands to fight money laundering. Surabaya Stock Exchange (SSX) shareholders agreed on December 6 to merge with the Jakarta Stock Exchange (JSX) by the end of 2007 to increase efficiency. On December 15, Fitch Ratings announced confirmed ratings for four domestic banks: Bank Negara Indonesia (BNI), Bank Danamon, NISP, and Bank Buana. This report uses an exchange rate of Rp 9,025/USD. End Summary.

Inflation Increases as Rice Prices Surge

12. On January 2, the Central Bureau of Statistics (BPS) announced that Indonesia's inflation rate accelerated in December for the first time in seven months, to 6.6% year-on-year (YoY) and 1.21% month-on-month (MoM). The significant MoM jump is mainly due to higher prices for rice, which experienced an 8% spike in the first three weeks of the month. The increase in rice prices contributed around 40% to December inflation. Core inflation remained relatively low and within BI's target range at 0.65% MoM and 6.03% YoY. "Inflationary pressures need to be watched. The government and the central bank will continue to target inflation of 6.5%," Finance Minister Sri Mulyani noted after the announcement.

Table 1: Inflation Components - December 2006

Component	MoM	YoY
Foodstuffs	3.12	12.94
Prepared food, beverages, tobacco	1.11	6.36
Housing, water, electric, fuel	0.74	4.83
Clothing	0.13	6.84
Health	1.05	5.87
Education, recreation/sports	0.07	8.13
Transportation, communication and financial services	0.10	1.02
Total	1.21	6.60
Core Inflation (1)	0.65	6.03

(1) Core inflation is a measure of inflation that excludes certain items that exhibit volatile price movements, i.e. energy and food products.

Source: Central Bureau of Statistics (BPS)

Bank Indonesia Slows Interest Rate Cuts

13. On January 4, 2007 Bank Indonesia (BI) cut its benchmark interest rate by 25 bps to 9.5%, following five monthly 50-bps cuts since August 2006. Analysts agree BI appears to be slowing the rate of monetary policy loosening and attempting to strike a prudent balance between the need to bring down interest rates to encourage bank lending while guarding against the flight of funds if the interest rate differentials become too narrow. BI Governor Burhanuddin Abdullah noted that the Board considered the

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macroeconomic situation in 2006 and future prospects for the economy when making its decision. "We are considering future risks as well as inflation targets for 2007 and 2008," he said. He added that there are still structural problems in Indonesia's economy such as the weak investment climate and market structure, inadequate infrastructure and low productivity. "These have resulted in a slow-performing economy," he said. Despite more than a half dozen interest rate cuts, BI still faces public pressure by the GOI to reduce interest rates, including from President Yudhoyono and other senior GOI officials.

GOI Swaps Bonds

14. On December 5, the MOF swapped bonds maturing in 2007-2011 totaling Rp 6.2 trillion (\$687 million) for 19-year debt priced to yield 11%. With this final debt swap, the MOF exchanged in 2006 a total of Rp 37.8 trillion (\$4.2 billion) in bonds maturing in 2007-2011 for longer maturity bonds, an amount equivalent to approximately 23% of GOI debt amortizations in 2007-2011. The GOI has been re-profiling its debt for several years through a series of maturity-extending swaps and buybacks to reduce the large number of bonds coming due in 2007-09.

Table 2: MOF Bond Swaps in 2006

Date	Amount (Rp trillion)	Old Bonds' Yield (%)	New Bonds' Yield (%)	New Bonds Tenor (yrs)
March 2	7.6	12.8 - 13.2	12.8	15
March 23	8.5	11.8 - 13.2	12.1	5
June 27	3.1	12.1 - 12.6	13.2	6
July 25	2.4	9.5 - 14	12.8	15
August 8	4.4	9.5 - 14	12.0	15
August 29	0.2	11.2 - 12.1	11.8	12
Sept. 26	0.1	9 - 10	11.3	19
Oct. 17	4.3	9.5 - 14	11.0	15
Nov. 21	0.9	9.3 - 11.3	11.0	8

Source: Ministry of Finance

2006 Budget Deficit Smaller than Target

15. On January 4, the MOF issued a report on the implementation of the 2006 budget showing that actual GOI spending up to December 29, 2006 was Rp 669.9 trillion (\$74.2 billion), or 95.8% of the budgeted amount. The report demonstrates that government spending was heavy in December 2006, since realized spending at the end of November was only been 75% of the targeted amount. The central government spent Rp 443.5 trillion (\$49.1 billion) or 92.7% of the targeted Rp 478.2 trillion (\$53 billion). Local government spending reached Rp 226.4 trillion (\$25.1 billion) or 102.5% of the targeted Rp 220.9 trillion (\$24.5 billion). MOF Director General for the Treasury Herry Purnomo said Parliament and GOI have agreed that unlike in 2005, unspent funds will not be carried over to 2007 in their existing allocation categories. Instead, unused 2006 funds will be re-allocated, possibly between ministries, a decision that should encourage ministries to spend their full budget allocations in the current fiscal year.

16. As of December 29, GOI revenues reached Rp 637.8 trillion (\$70.7 billion), or 96.8% of the full year target. Tax revenues make up the largest component of total revenues at Rp 409 trillion (\$45.3 billion) or 96.2% of the targeted Rp 425.1 trillion (\$47.1 billion). Non-tax revenue reached Rp 226.9 trillion (\$25.1 billion) or 98.7% of the targeted Rp 229.8 trillion (\$25.5 billion). The budget realization report indicated that the budget showed a deficit of Rp 32.1 trillion (\$3.6 billion), equivalent to 1.0% of Gross Domestic Product (GDP). The 2006 budget passed by Parliament targeted a deficit equivalent to 1.3% of GDP.

No Rupiah Intervention

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17. In a December 29 interview with the Asian Wall Street Journal (ASWJ), Finance Minister Sri Mulyani Indrawati reportedly said that the Indonesian government does not believe its currency is overvalued and has no intention of intervening in financial markets to cool inflows of foreign capital into stocks, bonds and other assets. She added that the GOI economic team believes that continued foreign investment will be critical to maintaining high GDP growth. "The (competitiveness) of the economy should not rely on exchange-rate policy. We are not manipulating the level (of the rupiah) -- we maintain policy consistency. This is what investors want to hear from us," Mulyani said. She also argued that Indonesia's economic situation is different from that of Thailand. According to the ASWJ report, the rupiah has appreciated about 7% against the dollar this year, less than half the increase in the value of the Thai baht. The average Rp/USD exchange rate stood at 9,166/USD in 2006, compared to 9,500/USD in 2005. The currency closed at 9,020/USD at the end of 2006.

JSX Third Best Performing Bourse in 2006

18. The Jakarta Stock Exchange's (JSX) composite index closed at 1,805 on December 28, the last trading day in 2006. The index increased by 55.3% in 2006, compared to a 16.4% increase in 2005 and 44.6% in 2004. The JSX was the third best performing stock exchange in the world in 2006 after bourses in China and Russia. JSX market capitalization surged by 55.6% in 2006, reaching Rp 1,246 trillion (\$138 billion) compared to Rp 801 trillion (\$89 billion) in 2005. There were 12 new listings in 2006, bringing the total number of listed companies in the JSX to 344.

Stock Exchanges Agree To Merge

19. In an extraordinary general meeting on December 6, shareholders of the Surabaya Stock Exchange (SSX) agreed to merge with the JSX.

Management expects the merger to be completed by the end of 2007 and looks forward to improved efficiency by combining the exchanges. The SSX lists about 200 stocks and 66 corporate bonds, while the JSX lists 344 stocks. JSX shareholders previously agreed to the merger in May 2006. The GOI recommended the two exchanges merge by the end of 2006 to improve the efficiency of Indonesia's capital markets under its July 2006 financial sector policy package.

Salary Increases for Central Bank

¶10. At a December 14 hearing, Parliament's Commission XI for Banking and Finance approved a salary increase for Bank Indonesia's employees of 3-4% for the board, and 7-10% for middle management and staff. Commission Chairman Awal Kusumah stated that the increase aims to adjust the current wage system and reduce the gap between the levels of employees. The Commission also approved BI's proposed budget for human resource management of Rp 2.8 trillion (\$310 million) in 2007. The approval is based on BI's projected revenue for 2007.

PPATK Signs Anti-Money Laundering MOUs

¶11. On December 5, the Financial Transaction Reporting and Analysis Center (Pusat Pelaporan dan Analisa Transaksi Keuangan or "PPATK") signed memoranda of understanding (MOUs) with the financial intelligence units of the Cayman Islands and South Africa. Under the MOUs, the parties agreed to exchange information linked to money laundering and terrorist financing. Indonesia launched the PPATK in October 2003 to help combat illicit money flows. The unit has already entered similar cooperation agreements with 17 other financial intelligence agencies.

Fitch Ratings for Danamon, NISP, Buana, BNI

¶12. In a December 15 press release, Fitch Ratings affirmed the ratings for Indonesia's third largest bank, state-owned Bank Negara Indonesia (BNI). Fitch also re-affirmed the ratings of Indonesia's fifth largest bank, Bank Danamon; fourteenth largest bank, Bank NISP; and sixteenth largest bank, Bank Buana. The outlook for all

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the ratings is stable. Fitch's press release made the following points about the ratings for the four banks:

--BNI's ratings reveal its continued weak asset quality, while noting moderate improvement in profitability and capital position. More stringent regulation of loan classification and weakening economic conditions in 2005 resulted in BNI's non-performing loans (NPLs) increasing from 13.7% of gross loans at the end 2005 to 16.6% in Q3 2006. Fitch viewed "with some concern" the rising trend in NPLs for the SME segment from 9.6% at end-2005 to 17.5% at the end of the third quarter of 2006, given that the SME segment will be a focus for future loan expansion (along with consumer loans). The agency also believes that BNI needs stronger reserves cover than the 40% level (of NPLs) at end-September 2006 given the generally weak recoveries expected for impaired loans.

--Danamon's ratings reflect its adequate capital position and reduced but still reasonably strong profitability due to its high-yield loan business, which helps to offset higher provisioning costs following weaker loan quality from end-2005.

--Bank NISP's ratings reflects support from its financially strong parent, Singapore-based OCBC Bank, which became a majority shareholder in early 2005, as well as its satisfactory profitability and a reasonably strong balance sheet with higher NPL offsets.

--Buana's ratings also indicates the strength of Singapore-based parent United Overseas Bank, as well as the bank's own solid capital position and profitability.

Table 3: Fitch Ratings for Danamon, NISP, Buana,

and BNI

	Danamon	NISP	Buana	BNI
Long-term foreign currency	BB-	BB-	BB-	BB-
Short-term foreign currency	B	B	B	B
National long-term	AA-	AA+	AA+	A+
Individual	C/D	C/D	C/D	D
Support	4	3	3	4

Source: www.fitchratings.com

Table 4: Selected Economic, Financial, and Trade Statistics,
September - December 2006

	Sep	Oct	Nov	Dec
CPI inflation (YoY)	14.55	6.29	5.27	6.60
CPI inflation (MoM)	0.38	0.86	0.34	1.21
Rp/USD Exch. rate(1)	9,235	9,107	9,140	9,020
30-day SBI rate (1)	11.25	10.75	10.25	9.75
Foreign Res. (\$ bn)(1)	42.3	39.9	41.6	42.6
JSX Composite Index(1)	1,534	1,583	1,719	1,805
Exports (\$ billion)	8.8	8.7	8.9	
Percent change (YoY)	16.7	16.4	17.6	
Imports (\$ billion)	5.7	4.5	5.9	
Percent change (YoY)	4.0	3.1	6.1	
Trade Balance	3.1	4.2	3.0	

Source: Bank Indonesia, BPS, JSX
(1) End of period

PASCOE